

**ASSEMBLY BILL**

**No. 664**

**Introduced by Assembly Member Correa**

February 19, 2003

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An act to add Sections 5100.1 and 6090.7 to the Business and Professions Code, and to add Sections 1513, 1514, 1515, 25511, 25537, 25538, and 25540.5 to the Corporations Code, relating to corporations.

LEGISLATIVE COUNSEL'S DIGEST

AB 664, as introduced, Correa. Corporations: accountability.

(1) Existing law provides for licensing of certified public accountants by the California Board of Accountancy and for licensing of attorneys by the State Bar of California.

This bill would require a certified public accountant that performs any audit required by law for a corporation to report certain information to the corporation's audit committee, including all critical accounting policies and practices to be used and all alternative disclosures and treatments that have been discussed with the management of the corporation. The bill would require an attorney retained by a corporation to report any evidence of a material violation of state or federal securities laws or a breach of fiduciary duty or similar violation by the corporation or any agent of the corporation. The bill would provide that the failure to comply with these provisions is a cause for disciplinary action against the accountant or attorney, as the case may be.

(2) Existing law imposes various requirements on corporations under the General Corporation Law and on issuers of corporate securities under the Corporate Securities Law of 1968.

This bill would require a corporation to disclose whether or not it has adopted a code of ethics for senior financial officials of the corporation. The bill would make it unlawful for any director or executive officer of an issuer of any equity security subject to the Corporate Securities Act of 1968 to purchase, sell, or otherwise acquire any equity security of the issuer acquired in connection with service or employment as a director or officer during any blackout period, as defined, and would provide remedies in the event of a violation. The bill would authorize the Commissioner of Corporations, during a lawful investigation involving possible violations of the Corporate Securities Law of 1968, to seek a court order if it appears to the commissioner that the issuer will make extraordinary payments to various parties, under which court order the issuer would be required to escrow those payments for 45 days pending the outcome of the investigation, and would specify the procedure to be followed in that regard. The bill would authorize the commissioner to issue an order to prohibit any person who has violated the Corporate Securities Law of 1968 from acting as an officer or director of any issuer if the conduct of the person demonstrates unfitness to serve in that capacity.

(3) Existing law specifies certain criminal penalties applicable to violations of the Corporate Securities Law of 1968, which generally provide various fines and maximum imprisonment for not more than 5 years.

This bill would provide for a fine of not more than \$10,000,000, or imprisonment for no more than 20 years, or both, for a person who knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry to any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of the Department of Corporations under the Corporate Securities Law of 1968. These provisions would also apply to any person who corruptly alters, destroys, mutilates, or conceals a record, document, or other object, with the intent to impair the object's integrity or availability for use in an official proceeding, or otherwise obstructs, influences, or impedes any official proceeding. Because the bill would create new crimes, it would impose a state-mandated local program.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.



This bill would provide that no reimbursement is required by this act for a specified reason.

Vote: majority. Appropriation: no. Fiscal committee: yes.  
State-mandated local program: yes.

*The people of the State of California do enact as follows:*

1 SECTION 1. Section 5100.1 is added to the Business and  
2 Professions Code, to read:

3 5100.1. In addition to the causes stated in Section 5100, the  
4 failure of a certified public accountant to comply with Section  
5 1513 of the Corporations Code shall also constitute grounds for the  
6 board to take any action for unprofessional conduct authorized by  
7 Section 5100.

8 SEC. 2. Section 6090.7 is added to the Business and  
9 Professions Code, to read:

10 6090.7. It is a cause for suspension, disbarment, or  
11 disciplinary action for any member retained by a corporation to  
12 fail to comply with Section 1514 of the Corporations Code, to the  
13 extent applicable.

14 SEC. 3. Section 1513 is added to the Corporations Code, to  
15 read:

16 1513. A certified public accountant that performs for any  
17 corporation any audit required by any law shall timely report to the  
18 audit committee of the corporation all of the following:

19 (a) All critical accounting policies and practices to be used.

20 (b) All alternative disclosures and treatments of financial  
21 information within generally accepted accounting principles that  
22 have been discussed with management officials of the corporation,  
23 ramifications of the use of those alternative disclosures and  
24 treatments, and the treatment preferred by the public accountant.

25 (c) Other material written communications between the  
26 certified public accountant and the management of the  
27 corporation, including any management letter or schedule of  
28 unadjusted differences.

29 SEC. 4. Section 1514 is added to the Corporations Code, to  
30 read:

31 1514. (a) Any attorney retained by a corporation shall report  
32 any evidence of a material violation of state or federal securities  
33 laws or breach of fiduciary duty or similar violation by the

1 corporation or any agent thereof to the chief legal counsel or the  
2 chief executive officer of the corporation.

3 (b) If the chief legal counsel or the chief executive officer does  
4 not appropriately respond to the evidence provided under  
5 subdivision (a) by adopting, as necessary, appropriate remedial  
6 measures or sanctions with respect to the violation, the attorney  
7 shall report the evidence to the audit committee of the corporation  
8 or to the board of directors.

9 SEC. 5. Section 1515 is added to the Corporations Code, to  
10 read:

11 1515. (a) A corporation shall disclose whether or not the  
12 corporation has adopted a code of ethics for senior financial  
13 officials of the corporation, applicable to its principal financial  
14 officer and comptroller or principal accounting officer, or persons  
15 performing similar functions, and if not, the reasons therefor.

16 (b) As used in this section, “code of ethics” means those  
17 standards as are reasonably necessary to do all of the following:

18 (1) Promote honest and ethical conduct, including the ethical  
19 handling of actual or apparent conflicts of interest between  
20 personal and professional relationships.

21 (2) Promote full, fair, accurate, timely, and understandable  
22 disclosure in complying with reporting requirements.

23 (3) Promote compliance with applicable governmental rules  
24 and regulations.

25 SEC. 6. Section 25511 is added to the Corporations Code, to  
26 read:

27 25511. (a) It shall be unlawful for any director or executive  
28 officer of an issuer of any equity security subject to this division  
29 to directly or indirectly purchase, sell, or otherwise acquire or  
30 transfer any equity security of the issuer during any blackout  
31 period with respect to the equity security if that director or  
32 executive officer acquires the equity security in connection with  
33 his or her service or employment as a director or executive officer.  
34 As used in this section, ‘blackout period’ shall have the same  
35 meaning, to the extent practicable, as the meaning of that term in  
36 Section 306 of the Sarbanes-Oxley Act of 2002 (P.L. 107-204).

37 (b) An action to recover profits in accordance with this section  
38 may be brought in a court of competent jurisdiction by the issuer,  
39 or by the owner of any security of the issuer in the name and on  
40 behalf of the issuer if the issuer fails or refuses to bring the action

1 within 60 days after the date of request, or fails diligently to  
2 prosecute the action thereafter, except that no such action shall be  
3 brought more than two years after the date on which the profit was  
4 realized.

5 (c) The commissioner shall adopt regulations to implement this  
6 section.

7 SEC. 7. Section 25537 is added to the Corporations Code, to  
8 read:

9 25537. (a) During the course of a lawful investigation by the  
10 commissioner involving possible violations of this division by an  
11 issuer of securities or any of its directors, officers, partners,  
12 controlling persons, agents, or employees, if it shall appear to the  
13 commissioner that it is likely that the issuer will make  
14 extraordinary payments, whether compensation or otherwise, to  
15 any of the foregoing persons, the commissioner may petition a  
16 court of competent jurisdiction for a temporary order requiring the  
17 issuer to escrow, subject to court supervision, those payments in  
18 an interest-bearing account for 45 days.

19 (b) A temporary order shall be entered by a court pursuant to  
20 this section only after notice and opportunity for a hearing, unless  
21 the court determines that notice and hearing prior to entry of the  
22 order would be impracticable or contrary to the public interest.

23 (c) A temporary order issued pursuant to this section shall  
24 become effective immediately, be served on the parties subject to  
25 it, and remain effective and enforceable for 45 days unless set  
26 aside, limited, or suspended by a court.

27 (d) The effective period of an order issued pursuant to this  
28 section may be extended by the court upon good cause shown for  
29 not longer than 45 additional days.

30 (e) (1) If the issuer or other person described in subdivision (a)  
31 is charged with any violation of this division before the expiration  
32 of the effective period of a temporary order issued pursuant to this  
33 section, the order shall remain in effect, subject to court approval,  
34 until the conclusion of any legal proceedings related thereto, and  
35 the affected issuer or other person shall have the right to petition  
36 the court for review of the order.

37 (2) If the issuer or other person described in subdivision (a) is  
38 not charged with any violation of this division before the  
39 expiration of the effective period of a temporary order issued  
40 pursuant to this section, the escrow shall terminate at the expiration

1 of the temporary order period, and the disputed payments, with  
2 accrued interest, shall be returned to the issuer or other affected  
3 person.

4 SEC. 8. Section 25538 is added to the Corporations Code, to  
5 read:

6 25538. The commissioner, after notice and opportunity for a  
7 hearing, may issue an order to prohibit, conditionally or  
8 unconditionally, and permanently or for a period of time as  
9 determined by the commissioner, any person who has violated this  
10 division from acting as an officer or director of any issuer if the  
11 conduct of that person demonstrates unfitness to serve as an officer  
12 or director of that issuer. The order shall be subject to judicial  
13 review.

14 SEC. 9. Section 25540.5 is added to the Corporations Code,  
15 to read:

16 25540.5. Any person who knowingly alters, destroys,  
17 mutilates, conceals, covers up, falsifies, or makes a false entry to  
18 any record, document, or tangible object with the intent to impede,  
19 obstruct, or influence the investigation or proper administration of  
20 any matter within the jurisdiction of the department pursuant to  
21 this division, or in relation to or contemplation of that matter, or  
22 who corruptly alters, destroys, mutilates, or conceals a record,  
23 document, or other object, or attempts to do so, with the intent to  
24 impair the object's integrity or availability for use in an official  
25 proceeding, or otherwise obstructs, influences, or impedes any  
26 official proceeding, or attempts to do so, shall upon conviction be  
27 fined not more than ten million dollars (\$10,000,000), or  
28 imprisoned in the state prison for not more than 20 years, or be  
29 punished by both that fine and imprisonment.

30 SEC. 10. No reimbursement is required by this act pursuant  
31 to Section 6 of Article XIII B of the California Constitution  
32 because the only costs that may be incurred by a local agency or  
33 school district will be incurred because this act creates a new crime  
34 or infraction, eliminates a crime or infraction, or changes the  
35 penalty for a crime or infraction, within the meaning of Section  
36 17556 of the Government Code, or changes the definition of a  
37 crime within the meaning of Section 6 of Article XIII B of the  
38 California Constitution.

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